FOREIGN GOVERNMENT-CONTROLLED INVESTMENTS IN THE UNITED STATES

The United States has been more open and receptive to foreign investment than other countries. It appears we are the only government that does not have the legal authority to reject an investment on general national interest grounds. We have maintained this policy because foreign investment, like domestic investment, substantially benefits the U.S. economy. There is concern, however, that investments in the United States, if controlled by foreign governments, may have adverse effects.

There are very few data available on the operations in the United States of firms controlled by foreign governments. There is, however, a growing tendency for governments to intervene aggressively in markets to resolve international trade and investment problems that are perceived to threaten their national economic, social or political goals (e.g. increased employment, reduction of balance of payments deficits, or sectoral development). There is concern is that such interventions, particularly by certain governments who have a non-market philosophy, could influence the operations of foreign government-controlled subsidiaries in the United States to a degree sufficient to distort market performance here.

One factor that may create difficulties in responding to this problem is defining what constitutes government ownership. One possible approach is to adopt a definition based on percent of voting shares. This is not an ideal solution, however, since the nature of government control will vary from case to case independent of formal voting power and may depend on the attitude of the government with control.

Government Intervention

Government intervention in the market takes a number of forms. Some of the more common forms include:

-- protectionist measures;

-- buy national or discriminatory government procurement policies;

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-- subsidies to declining or inefficient industries;

-- tax concessions on export earnings;

-- subsidized export credit financing;

-- counter-trade, buyback, and offset agreements; and

-- performance requirements on foreign, and sometimes domestic investors.

It is apparent that governments, including the United States Government, have intervened in the market and will continue to intervene in response to political or economic pressures. Pressures for government intervention of this type can be expected to be greater and more likely, however, where a government has a vested equity interest in the operations of an entity. The performance of a government-owned entity and the implications of its operation for the home markets are likely to be more closely scrutinized than its private-sector counterpart. Political and economic pressures are also more likely to be applied to a government-owned entity than to a private entity to ensure that the government-owned entity conforms to the policies and goals of the government.

Ownership also permits the government to control these entities more easily than private enterprises, and to implement government policy through the management of entity operations without any public announcement or detection. Decisions, made allegedly for commercial reasons, do not have to be debated publicly and usually are not subject to legal review, as are government regulations. In instances where the government is the sole buyer (e.g., in many cases in telecommunications) and it owns the seller there could be great pressures for it to buy from the controlled seller.

Reciprocity

Adoption of reciprocal measures by the United States Government has been suggested as a potential policy response to foreign government intervention in trade and investment. Reciprocity in general, however, is not an effective response to foreign investment restrictions. Governments generally restrict incoming foreign investment for nationalistic purposes, e.g., to ensure domestic control over industry. Governments often favor retaining capital in their own country and may

restrict their citizens ability to make outgoing foreign investments abroad in an effort to obtain a short-term foreign exchange benefit and in the belief that such restrictions will translate into increased domestic investment. Hence, restrictions on foreign investment are likely to be welcomed, particularly when imposed by attractive host countries. The Canadian Government, for example, does not have foreign exchange restrictions, but, given the Canadian Government's desire to increase domestic investment, is unlikely to oppose U.S. restrictions on foreign direct investment.

The adoption of a reciprocal policy on foreign investment by the United States is, therefore, unlikely to lead to any modification of the restrictive foreign investment policies of most countries; but it would result in a reduction of foreign direct investment in the United States and its associated benefits.

Where foreign governments discriminate against U.S. investment, the U.S., nevertheless, might be able to exert pressure on foreign governments by imposing selective restrictions against foreign governmental investment. The extent of the leverage would depend, however, on the relative importance of an investment in the U.S. compared to other investment opportunities.

Inter-Agency Working Group on International Investment Policy Assessment

An inter-agency working group reviewed potential problems associated with foreign governmental direct investments in the United States, and it has determined that existing U.S. mechanisms may suffer from a number of shortcomings in addressing potential problems which may arise in this area. These shortcomings include a lack of adequate information and the inappropriateness of existing laws and remedies. U.S. laws were not designed to respond to peculiar problems raised by foreign governments ownership.

The only broad legal powers that the United States Government presently possesses are contained in the International Economic Emergency Powers Act (IEEPA). The IEEPA, which was enacted in 1977, can be triggered only by the declaration of a national emergency by the President, and its reputation as an asset-blocking statute makes foreign investors, particularly depositors, very nervous. Hence, it would be

practically impossible to invoke this statute in response to a specific, discrete investment. It has been invoked only during the Iranian hostage crisis, and even in that situation questions were raised concerning the appropriateness of its use. It is, therefore, not a power that the United States should rely on to respond to foreign direct investments damaging to U.S. national interests.

The Committee on Foreign Investment in the United States (CFIUS) reviews foreign governments' direct investments in the United States but it must rely on voluntary notification of such investments. While investments involving acquisitions of large publicly-traded companies are likely to come to the Committee's attention, even if the Committee is not formally notified by the foreign government, a number of investments by government-controlled firms have occurred and have not come contemporaneously to the Committee's knowledge.

The Committee currently has no legal authority to require that a foreign government delay or modify an investment in the United States. In addition, there is no systematic collection of information presently available to the Committee on the acquisition or operation of foreign government-controlled firms in the United States.

The Inter-Agency Working Group on International Investment Policy has been reviewing this issue for some time, and three possible views have surfaced:

1. There is no evidence that there are real problems associated with foreign government-controlled investments in the United States or that existing laws are not adequate to deal with foreseeable problems. The U.S. Government should take no further action until additional evidence establishes that the United States is being harmed by such investments.

2. There may be real problems associated with foreign government-controlled investments and current U.S. laws may not be adequate. However, it would be preferable not to take action at this time.

3. There may be real problems associated with foreign governmental direct investments in the United States and the U.S. Government should examine the possibility of seeking legislation to require mandatory advance notification of foreign governmental investments and

authorizing the CFIUS to monitor the operations of established U.S. subsidiaries of foreign government-controlled firms.

If the United States Government were to require notification in advance of foreign governmental direct investments it would need to consider what types of penalities would be imposed for non-compliance, whether the responsible agency would have the power to subpoena information necessary to complete a review of the investment and whether specific delay requirements would be provided between the time of notification and/or filing of information and the completion of the transaction.

If the United States decided to monitor the operation of existing foreign governmental entities in the United States it could expand existing U.S. reporting systems. Currently, the Bureau of Economic Analysis (BEA) and the Securities and Exchange Commission have reporting requirements. BEA collects parent-subsidiary financial information for use in the U.S. Balance of Payments statistics, but provides data only in aggregated form. The Securities and Exchange Commission collects and makes public detailed financial and operating data on publicly-traded U.S. corporations; however, privately-held firms may fall outside of the SEC reporting requirements. Also the questions posed may be aimed at abuses by private, not public owners. The United States could extend and expand the BEA or SEC requirements or alternatively, a new reporting system could be developed.

Swapping CCC Butter for Soviet Strategic Materials

Issue: The USSR is in the market for as much as 100,000 tons of butter. To compete with current EC offers of subsidized butter, USDA has proposed that the Commodity Credit Corporation (CCC) and GSA barter CCC-owned butter at world market prices for Soviet strategic materials for the U.S. national stockpile. The barter might be linked to Soviet purchases of U.S. grain. It could be carried out either through a government-to-government barter arrangement or through U.S. barter contractors. (Specific USDA proposal attached.)

The SIG should consider whether the USG should barter butter for Soviet strategic materials, either directly or through third parties, and prepare the issue for Presidential decision.

Advantages:

-- Would reduce CCC butter inventory (currently 185,000 tons and growing), reducing program costs.

-- Would swap a perishable commodity for strategic materials for the national stockpile for which we are below target, without incurring a budgetary cost.

-- Would compete with the EC for the Soviet market, countering EC export subsidies and increasing pressures for reform of the EC's general export subsidy program.

-- If linked to commercial grain sales, would substantially increase potential U.S. grain exports to the USSR, in competition with subsidized EC grain exports.

-- Wouldn't be a major advantage to the USSR, since the USSR would otherwise buy butter at similar prices from other sources.

Disadvantages:

-- Would make it more difficult to oppose the wider use of countertrade which has often worked to the detriment of U.S. firms doing business in the USSR and elsewhere.

-- Would be subsidized sale to the USSR, inconsistent with our Soviet policy, with our objectives vis-a-vis our Allies, and with our trade policy. Would also save the USSR foreign exchange it would otherwise use to purchase butter from other sources.

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-- Would send the wrong signal to both the USSR and our Allies at a sensitive time in our relations with them. Other exporters of butter (the EC and New Zealand) and of the strategic materials we acquire from the Soviets could be upset.

-- Could reduce domestic pressures to reform the dairy support program, if CCC stocks are reduced and put to good use.

-- Potential strong criticism from U.S. consumers, who pay higher prices for U.S. butter than would the Soviets, and from interested U.S. companies, if not given the opportunity to participate in the barter deal.

Discussion

The proposed barter of agricultural commodities such as butter for strategic materials from the Soviet Union has important implications for U.S. international trade and foreign policies, as well as our domestic agricultural and budget situations and U.S. objectives for the national stockpile.

The proposal appears to meet CCC requirements for bartering CCC-owned commodities and to be consistent with the President's directive to restructure the strategic stockpile, which encourages the use of barter. CCC statutes specify a number of conditions for barter transactions: CCC must own the commodities; the barter must be bilateral; the bartered commodities must not displace cash sales and must not unduly disrupt world market prices; the U.S. must be a net importer of the material acquired, which must be foreign-produced; the acquired material must be less subject to deterioration and cheaper to store than the counterpart agricultural commodity; and CCC must use private channels of trade. During the 1950s and 1960s, CCC bartered approximately $1.6 billion in agricultural commodities for strategic materials.

The price received for the butter would approximate world market prices, but would be well below CCC acquisition costs and the cost of butter to U.S. consumers. The trade would, however, relieve CCC of storage and interest costs and would acquire for the U.S. Government commodities less susceptible to spoilage and of greater strategic interest.

The transaction raises the question of whether U.S. Government barter operations to acquire materials for the strategic stockpile would encourage foreign governments such as the USSR to require barter or countertrade as a prerequisite for U.S. export sales. However, it might serve as needed leverage to substantially increase U.S. grain exports.

EXECUTIVE SUMMARY

The USSR will import up to 225,000 MT of butter in CY1983. Barter of CCC-owned butter for USSR-owned strategic material could be linked to a Soviet agreement to import as much as an additional 6 million tons of U.S. grain (over current estimated imports of 8 million tons of U.S. grain). Two options to implement this butter for strategic materials arrangement are available: (1) a Government-to-government barter arrangement, or (2) use of U.S. barter contractors. Details and implications of this proposal are spelled out in the attached paper.

BARTER ARRANGEMENT WITH THE USSR

BACKGROUND

It is estimated that during CY 1983, the USSR will import up to 225,000 MT of butter. The major suppliers of butter to the USSR have been the EC, Finland, Sweden and New Zealand. The USSR is currently interested in acquiring up to 100,000 MT, and it is expected that the EC will make a strong effort to conclude an arrangement for this amount within the next few weeks. A barter arrangement involving the exchange of CCC-owned butter and USSR strategic materials for the national strategic stockpile would probably place the U.S. in competition with the EC.

PROPOSED STRATEGY FOR LEVERAGING GRAIN TRADE

The barter of CCC-owned butter to the USSR for strategic materials would be of special importance to them and could be linked with a Soviet agreement to purchase a larger quantity of U.S. grain. Such a commitment would probably not be entered into in writing, but would need to be discussed and clearly understood. In the current October/September year, the Soviets are currently projected to import a total of 38 million tons of grain from all origins, including 8 million from the U.S. In agreeing to barter U.S. butter to them, we could ask that this be increased to perhaps as much as 14 MMT.

AUTHORITY

CCC has broad legal authority to barter CCC-owned butter for strategic materials and to hold title to the strategic material until transferred to the stockpile (See attached OGC memo for detailed opinion).

NATIONAL STRATEGIC STOCKPILE

The USSR produces the following strategic materials which are deficit to the stockpile (See attach table for USSR production, exports and imports).

STRATEGIC MATERIAL	STOCKPILE GOAL	STOCKPILE SHORTFALL
COBOLT	85,400,000 Lbs.	41,607,769 Lbs.
NICKEL	200,000 ST	167,790 ST
TITANIUM SPONGE	195,000 SDT	195,000 SDT
PALLADIUM	3,000,000 Tr Oz	1,747,212 Tr Oz
PLATINUM	1,310,000 Tr Oz	870,402 Tr Oz
IRIDIUM	98,000 Tr Oz	81,010 Tr Oz

The materials must meet GSA specifications. GSA would provide a stockpile site and manage the inventory.

From a transportation cost standpoint, it is to CCC's advantage to negotiate for cobolt, palladium and platinum. (See Cargo Preference section).

METHOD OF OPERATION

OPTION 1. GOVERNMENT TO GOVERNMENT BARTER ARRANGEMENT.

-- CCC, in cooperation with GSA, would enter into an agreement with the USSR covering the kind(s) quantity, specification and delivery of the strategic materials.

-- CCC would negotiate the agreement with the USSR covering the quantity, quality and delivery of the butter.

-- CCC would delivery the butter to the USSR FAS U.S. port. Ocean transport to be furnished by USSR. (Cargo preference not applicable)

-- The USSR would deliver the strategic material to CCC C&F U.S. port. Agreement would provide that 50 percent of the material would be shipped on U.S. flag vessels to comply with Cargo Preference Act.

-- CCC would accept title to the materials at U.S. ports and would pay domestic transporation costs of the strategic material from U.S. port to the GSA storage site.

-- GSA would pay the cost of placing the material in the storage site and all subsequent costs of maintaining the inventory.

OPTION 2. USE OF U.S. BARTER CONTRACTORS

-- CCC would issue invitations for U.S. bidder to enter into a barter arrangement with the USSR under which the contractor would deliver CCC-owned butter (from CCC-stocks and newly purchased unsalted butter of 82 percent milkfat) to the USSR and receive for the account of CCC, strategic materials from the USSR.

-- CCC would accept offers on the basis of the most viable proposed arrangement and proposed barter exchange.

-- CCC and GSA would establish a range for the value of the material (delivered USSR port) and CCC would establish a range for the value of the butter delivered FAS U.S. ports. The successful barter contractor would negotiate within these ranges and could only deviate with the approval of CCC and GSA.

-- The barter contractor would furnish a performance bond in favor of CCC for an agreed upon amount. CCC would draw against the performance bond in the event the barter contractor failed to carry out its responsibilities under the agreement with CCC.

-- CCC would deliver the butter to the barter contractor FAS U.S. port. Ocean transportation to be furnished by the USSR (Cargo preference not applicable).

-- The barter contractor would deliver the strategic material to CCC basis C&F U.S. ports. The agreement between CCC and the barter contractor would provide that the barter contractor pay the cost of ocean transportation and related charges, and that 50 percent of the material be shipped on U.S. flag vessels to comply with the Cargo Preference Act.

-- CCC would accept title to the materials at U.S. ports and would pay domestic transportation costs of the materials from U.S. ports to the GSA storage site.

-- GSA would pay the cost of placing the material in the storage site and all subsequent costs of maintaining the inventory.

-- The barter contractor would receive a quantity of the material at U.S. ports as payment for the barter exchange fee, ocean transportation costs and other related costs approved by CCC. The quantity of the material would be based on the barter exchange fee.

Comments

A barter arrangement would have the following advantages:

-- Reduce the inventory of CCC-owned butter and the amount which would otherwise be purchased by CCC under its price support program, thereby reducing program costs.

-- The displacement of EC exports of butter to the USSR.

-- CCC would swap a pershiable commodity for a strategic material needed for the national stockpile which would have a longer storage life. This would probably be looked upon as a favorable arrangement by the majority of the U.S. public.

-- Positive reaction from most dairy farmers and some from U.S. public.

-- Would benefit the U.S. in general by the acquisition of materials needed for the national stockpile.

-- CCC could later receive reimbursement from GSA for some of its program outlay.

-- Purchase unsalted, 82 percent milkfat butter. Projections are that CCC will purchase about 390 million pounds (172,365 MT) of butter in FY83. One hundred thousand metric tons would represent 56 percent of CCC's projected purchases. CCC buys 80 percent of its butter during the period January-June.

Other Considerations

See the attached statement prepared by ASCS of its concern regarding the delivery of unsalted, 82 percent milkfat butter.

RECOMMENDATION ON QUALITY OF BUTTER.

Use a combination of all options to provide the quantity of butter needed. CCC should purchase unsalted 82 percent milkfat butter for delivery January thru June and during the last part of the year should swap CCC-owned butter for unsalted 82 percent milkfat butter. This would prevent heavy purchases by CCC during the off-flush period. The CCC-owned butter would be diverted into the domestic market and would prevent inflated prices during peak use of high milkfat products such as ice cream.

It is believed that by using a combination of the options, CCC could deliver up to 100,000 MT. If only a direct purchase is used, consideration should be given to a maximum of 50,000 MT per year.

Reimbursement to CCC

Currently, GSA does not have funds which could be used to reimburse CCC for the market price of the strategic materials. However, CCC has authority to hold title to the materials. Options available to CCC include:

-- Provide support to GSA to obtain an budget sufficient to reimburse CCC for the materials.

-- Support legislation which would authorize CCC on a one-time arrangement to transfer title of the materials acquired under this arrangement to GSA without reimbursement.

-- Support legislation which would authorize the GSA to sell the materials for the account of CCC.

CARGO PREFERENCE

The Cargo Preference Act would apply to the shipment of the strategic material since the material is being acquired under a government contract.

The Cargo Preference Act would not apply to the shipment of the butter since the value of the butter would be negotiated at world market prices and delivered FAS U.S. ports and the arrangement would not involve any credit arrangements.

PRIOR PROPOSALS

Attached are letters from Philbro-Salomon Inc. and Cometals, Inc. regarding a barter arrangement with the USSR.

FRICES

Butter

World butter price (fresh, unsalted,
82 percent butterfat), f.o.b. Europe....................$2,025/MT ($.92/lb.)

Estimated ocean freight, U.S. east
coast to Black Sea port..................................$150/MT
($.07/lb.)[1/]

F.o.b. U.S. east coast port.................$1,875/MT ($.85/lb.)

Stowage Charges...$33.29/MT
($1.51/cwt)

F.e.s. U.S. east coast port.................$1,840/MT ($.84/lb.)

Strategic Materials

GSA material on prices is attached.

QUALITY OF BUTTER

The inventory of CCC-owned butter is salted with 80 percent milkfat. The USSR is interested in butter that is unsalted and 82 percent milkfat. (See attached detailed study by ASCS).

Options available

-- Negotiate with the USSR to accept butter directly from CCC inventory. USSR preference and usual imports of butter are of unsalted, 82 percent milkfat. The U.S. may be able to negotiated for small quantities of CCC-owned butter.

-- Swap CCC-owned butter with manufacturers for unsalted, 82 percent milkfat butter. This could prevent major price swings in low production months since the CCC-owned butter would go into the domestic market.

1/ Ocean freight rates are estimated. A published conference rate for refrigerated butter is not available according to the Ocean Transportation Division, GSM.